

108TH CONGRESS  
1ST SESSION

# S. 26

To amend the Internal Revenue Code of 1986 to provide that dividend and interest income of individuals not be taxed at rates in excess of the maximum capital gains rate.

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IN THE SENATE OF THE UNITED STATES

JANUARY 7, 2003

Mrs. HUTCHISON introduced the following bill; which was read twice and referred to the Committee on Finance

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## A BILL

To amend the Internal Revenue Code of 1986 to provide that dividend and interest income of individuals not be taxed at rates in excess of the maximum capital gains rate.

1       *Be it enacted by the Senate and House of Representa-*  
2       *tives of the United States of America in Congress assembled,*

3       **SECTION 1. DIVIDENDS AND INTEREST OF INDIVIDUALS**  
4               **TAXED AT CAPITAL GAIN RATES.**

5       (a) IN GENERAL.—Section 1(h) of the Internal Rev-  
6       enue Code of 1986 (relating to maximum capital gains  
7       rate) is amended by adding at the end the following new  
8       paragraph:

1           “(13) DIVIDENDS AND INTEREST TAXED AS  
2       NET CAPITAL GAIN.—

3           “(A) IN GENERAL.—For purposes of this  
4       subsection, the term ‘net capital gain’ means  
5       net capital gain (determined without regard to  
6       this paragraph), increased by qualified dividend  
7       income and qualified interest income.

8           “(B) QUALIFIED DIVIDEND INCOME.—For  
9       purposes of this paragraph—

10           “(i) IN GENERAL.—The term ‘quali-  
11       fied dividend income’ means dividends re-  
12       ceived from domestic corporations during  
13       the taxable year.

14           “(ii) CERTAIN DIVIDENDS EX-  
15       CLUDED.—Such term shall not include—

16           “(I) any dividend from a corpora-  
17       tion which for the taxable year of the  
18       corporation in which the distribution  
19       is made, or the preceding taxable  
20       year, is a corporation exempt from tax  
21       under section 501 or 521,

22           “(II) any amount allowed as a  
23       deduction under section 591 (relating  
24       to deduction for dividends paid by  
25       mutual savings banks, etc.), and

1 “(III) any dividend described in  
2 section 404(k).

3 “(iii) MINIMUM HOLDING PERIOD.—  
4 Such term shall not include any dividend  
5 on any share of stock with respect to which  
6 the holding period requirements of section  
7 246(c) are not met.

8 “(C) QUALIFIED INTEREST INCOME.—For  
9 purposes of this paragraph, the term ‘qualified  
10 interest income’ means—

11 “(i) interest on deposits with a bank  
12 (as defined in section 581),

13 “(ii) amounts (whether or not des-  
14 ignated as interest) paid, in respect of de-  
15 posits, investment certificates, or  
16 withdrawable or repurchasable shares,  
17 by—

18 “(I) a mutual savings bank, co-  
19 operative bank, domestic building and  
20 loan association, industrial loan asso-  
21 ciation or bank, or credit union, or

22 “(II) any other savings or thrift  
23 institution which is chartered and su-  
24 pervised under Federal or State law,

the deposits or accounts in which are insured under Federal or State law or which are protected and guaranteed under State law,

“(iii) interest on—

“(I) evidences of indebtedness (including bonds, debentures, notes, and certificates) issued by a domestic corporation in registered form, and

“(II) to the extent provided in regulations prescribed by the Secretary, other evidences of indebtedness issued by a domestic corporation of a type offered by corporations to the public,

“(iv) interest on obligations of the United States, a State, or a political subdivision of a State (not excluded from gross income of the taxpayer under any other provision of law), and

“(v) interest attributable to participation shares in a trust established and maintained by a corporation established pursuant to Federal law.

“(D) SPECIAL RULES.—

1 “(i) AMOUNTS TAKEN INTO ACCOUNT  
2 AS INVESTMENT INCOME.—Qualified divi-  
3 dend income and qualified interest income  
4 shall not include any amount which the  
5 taxpayer takes into account as investment  
6 income under section 163(d)(4)(B).

7 “(ii) NONRESIDENT ALIENS.—In the  
8 case of a nonresident alien individual, sub-  
9 paragraph (A) shall apply only—

10 “(I) in determining the tax im-  
11 posed for the taxable year pursuant to  
12 section 871(b) and only in respect of  
13 amounts which are effectively con-  
14 nected with the conduct of a trade or  
15 business within the United States,  
16 and

17 “(II) in determining the tax im-  
18 posed for the taxable year pursuant to  
19 section 877.

20 “(iii) TREATMENT OF DIVIDENDS  
21 FROM REGULATED INVESTMENT COMPA-

1 NIES AND REAL ESTATE INVESTMENT  
 2 TRUSTS.—

**“For treatment of dividends from regulated investment companies and real estate investment trusts, see sections 854 and 857.”**

3 (b) EXCLUSION OF DIVIDENDS AND INTEREST FROM  
 4 INVESTMENT INCOME.—Subparagraph (B) of section  
 5 163(d)(4) of the Internal Revenue Code of 1986 (defining  
 6 net investment income) is amended by adding at the end  
 7 the following flush sentence:

8 “Such term shall include qualified dividend in-  
 9 come (as defined in section 1(h)(13)(B)) or  
 10 qualified interest income (as defined in section  
 11 1(h)(13)(C)) only to the extent the taxpayer  
 12 elects to treat such income as investment in-  
 13 come for purposes of this subsection.”

14 (c) TREATMENT OF DIVIDENDS FROM REGULATED  
 15 INVESTMENT COMPANIES.—

16 (1) Subsection (a) of section 854 of the Inter-  
 17 nal Revenue Code of 1986 (relating to dividends re-  
 18 ceived from regulated investment companies) is  
 19 amended by inserting “section 1(h)(13) (relating to  
 20 maximum rate of tax on dividends and interest)  
 21 and” after “For purposes of”.

22 (2) Paragraph (1) of section 854(b) of such  
 23 Code (relating to other dividends) is amended by re-  
 24 designating subparagraph (B) as subparagraph (C)

and by inserting after subparagraph (A) the following new subparagraph:

“(B) MAXIMUM RATE UNDER SECTION 1(h).—

“(i) IN GENERAL.—If the sum of the aggregate dividends received, and the aggregate interest described in section 1(h)(13)(C) received, by a regulated investment company during any taxable year is less than 95 percent of its gross income, then, in computing the maximum rate under section 1(h)(13), rules similar to the rules of subparagraph (A) shall apply.

“(ii) GROSS INCOME.—For purposes of clause (i), in the case of 1 or more sales or other dispositions of stock or securities, the term ‘gross income’ includes only the excess of—

“(I) the net short-term capital gain from such sales or dispositions, over

“(II) the net long-term capital loss from such sales or dispositions.”

(3) Subparagraph (C) of section 854(b)(1) of such Code, as redesignated by paragraph (2), is

1       amended by striking “subparagraph (A)” and insert-  
 2       ing “subparagraph (A) or (B)”.

3           (4) Paragraph (2) of section 854(b) of such  
 4       Code is amended by inserting “the maximum rate  
 5       under section 1(h)(13) and” after “for purposes of”.

6       (d) TREATMENT OF DIVIDENDS RECEIVED FROM  
 7       REAL ESTATE INVESTMENT TRUSTS.—Section 857(c) of  
 8       the Internal Revenue Code of 1986 (relating to restric-  
 9       tions applicable to dividends received from real estate in-  
 10      vestment trusts) is amended to read as follows:

11       “(c) RESTRICTIONS APPLICABLE TO DIVIDENDS RE-  
 12      CEIVED FROM REAL ESTATE INVESTMENT TRUSTS.—

13           “(1) IN GENERAL.—For purposes of section  
 14      1(h)(13) (relating to maximum rate of tax on divi-  
 15      dends and interest) and section 243 (relating to de-  
 16      ductions received by corporations), a dividend re-  
 17      ceived from a real estate investment trust which  
 18      meets the requirements of this part shall not be con-  
 19      sidered a dividend.

20           “(2) TREATMENT AS INTEREST.—

21           “(A) IN GENERAL.—For purposes of sec-  
 22      tion 1(h)(13), in the case of a dividend (other  
 23      than a capital gain dividend, as defined in sub-  
 24      section (b)(3)(C)) received from a real estate  
 25      investment trust which meets the requirements



of this part for the taxable year in which it  
paid—

“(i) such dividend shall be treated as  
interest if the aggregate interest received  
by the real estate investment trust for the  
taxable year equals or exceeds 75 percent  
of its gross income, or

“(ii) if clause (i) does not apply, the  
portion of such dividend which bears the  
same ratio to the amount of such dividend  
as the aggregate interest received bears to  
gross income shall be treated as interest.

“(B) ADJUSTMENTS TO GROSS INCOME  
AND AGGREGATE INTEREST RECEIVED.—For  
purposes of subparagraph (B)—

“(i) gross income does not include the  
net capital gain,

“(ii) gross income and aggregate in-  
terest received shall each be reduced by so  
much of the deduction allowable by section  
163 for the taxable year (other than for in-  
terest on mortgages on real property  
owned by the real estate investment trust)  
as does not exceed aggregate interest re-  
ceived by the taxable year, and

1 “(iii) gross income shall be reduced by  
2 the sum of the taxes imposed by para-  
3 graphs (4), (5), and (6) of section 857(b).

4 “(C) AGGREGATE INTEREST RECEIVED.—  
5 For purposes of this subsection, aggregate in-  
6 terest received shall be computed by taking into  
7 account only interest which is described in sec-  
8 tion 1(13)(C).

9 “(D) NOTICE TO SHAREHOLDERS.—The  
10 amount of any distribution by a real estate in-  
11 vestment trust which may be taken into account  
12 as interest for purposes of section 1(h)(13)  
13 shall not exceed the amount so designated by  
14 the trust in a written notice to its shareholders  
15 mailed not later than 45 days after the close of  
16 its taxable year.”

17 (e) EFFECTIVE DATE.—The amendments made by  
18 this section shall apply to taxable years beginning after  
19 December 31, 2002.

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